Economic Development Requires a State of Mind

WASHINGTON – Let’s start with a basic notion: economic development is a new phenomenon in human history. This makes it difficult to understand it; let alone produce it at will. Furthermore, intellectual biases based on the fundamental rationality of the human being that would make him naturally predisposed to maximize economic advantage, contributed to intellectual confusion as to what really causes and or makes development possible.

Let us not forget that for tens of thousands of years humans lived on earth pretty much like the other creatures. They came into the world. They were engaged in looking for and finding food. They devised ways to fend off predators, sometimes successfully sometimes not. They reproduced when possible, often fell prey of disease, and usually they died young because of hunger, disease or violence visited upon them by predators or other humans. For tens of thousands of years there was no such thing as development as we understand it today.

Growth is New

Both the notion and the reality of “economic growth” –especially the fast paced economic growth that has been more the norm, rather than the exception, in the western world in the last fifty years– are new. Although for many Westerners “growth” seems to have become self-evident as a reality and thus achievable as a goal, it should be emphasized that this phenomenon represents a “revolutionary” shift vis-à-vis anything that mankind had known until relatively recent times. The only known “reality” that both shaped and conditioned the worldview of millions for tens of thousands of years was that the only possible result of human activity is (at best) to reproduce what already exists.

The idea that it is indeed both desirable and possible to improve material conditions through human planning, the invention of new tools and methods whose outcome should be to increase the quantity, the variety and the quality of what is available, is new. The idea that one can devise and then apply new techniques and tools to activities such as handicrafts or manufacturing that would augment both total output and its quality; or that it is possible to improve upon the techniques related to the old ones (agriculture and animal husbandry) is new.

Indeed, the very notion that through human ingenuity and applied creativity it is possible to systematically produce and create something "more" than what already exists, if looked at against the backdrop of the long history of mankind, is truly "revolutionary". But how did all this happen, and why? And, by the same token, given the reality of development somewhere, how can we bring it elsewhere, where it has not occurred yet?

As such a crucial transformation did not occur as a clear, discreet experience, we have the consequent difficulty to spell out the ingredients, the dynamics and the environment that gave life in past instances –and that can give life today– to economic development or progress.

For the longest time, most theories were shaped by an assumption of a dominant rational trait within the human psyche that would lead humans to actions aimed at maximizing utility. But empirical evidence shows that this is not true; at least not all the time. In fact, not even most of the time. What is true instead is that notions that are conducive to development can be learnt. *However, the fact that they can be learnt does not mean that they will be easily embraced, as soon as people are exposed to them*. For such an assimilation to take place, a significant transformation of the human psyche was and is a necessary precondition. First and foremost a transformation that allows the psyche to begin to conceive, in the abstract, something that does not yet exist in the material, tangible reality, for development is about building an idea, not yet in the here and now.

However, because the role of the psychological, “intangible” psychological factors necessary to trigger an approach consistent with development were overlooked and thus not properly considered, the students of economics concentrated a disproportionate amount of attention on the tangible and material factors, the building blocks of development, attributing thus economic development to a change in material circumstances. This is a bit like saying that in order to be a great painter, an individual does indeed need canvass, various paints and brushes. Of course, he does. But the availability of these tools do not guarantee success as a painter.

This narrow approach has created distortions that have had a significant impact in shaping policies aimed at fostering growth in developed but especially in underdeveloped countries. By overemphasizing the need to improve material circumstances, (this is of course a necessary condition), we have somehow lost the point that the main agent of change is the human psyche. For it is the psyche that provides the sense of need, the orientation and the direction of sustained intellectual energies that can be mobilized materially toward this or that pursuit.

Economic Development: A Recent Revolution

Just to emphasize how new all this is, let us remember that, although they may be common place now (at least in the western or westernized world), until three hundred years ago, concepts, ideas, theories about “economic development” just did not exist. Until the inception of the industrial revolution in Great Britain during the XVIII Century, with the exception of the ruling elites that had secured for themselves positions of power and privilege in different societies, for most people, life had been following patterns focused on survival that had existed for millennia.

Furthermore, economic development did not start with a “bang”. Its inception in the early XVIII century, while setting in motion a process with incredible long-term consequences, was barely noticed by most. Indeed, another two hundred years had to go by for an industrial revolution based on new technologies and capitalistic enterprises to expand from its initial base in Great Britain and to reach a significant momentum in Western Europe and North America. It took that long for this transformation to produce at least some truly benign economic effects for significantly large numbers of people living in those parts of the world, in terms of improved quality of living. Throughout this time, the phenomenon was studied and analyzed. Regardless as to the wildly diverging theories, at least all this new attention created and spread awareness about the existence of “growth” and about a range of new ideas and concepts based on the premise that humans, through economic activities, can change for the better individual as well as societal circumstances.

Still, even at the dawn of the XX century, when industrialization was in full swing in Europe and North America, relatively few benefited from it. Only a small number of people were involved in and mastered the complexities of entrepreneurial activities that, as experience has proven, are a necessary foundation for widespread, sustained economic growth. One century after the successful harnessing of steam, and after the use of electricity had become common and after the development of the internal combustion engine —all of which allowed the beginning of modern, large-scale industry and manufacturing —the majority of the people *in the industrial countries* were not significantly affected by these epochal changes.

Likewise, after the telegraph, the telephone and the radio had already found large industrial and commercial applications and had thus become part of the broadly used technology, this progress barely touched or altogether eluded *the majorities in the most technologically advanced and economically better off countries.*

In truth, at the beginning of the age of the assembly line and mass production not much had changed in the daily lives of most ordinary people living in the western world. After almost a century of furious technological innovation that had revolutionized quantity and quality of industrial output as well as the structure of many economic activities and business relations, at the dawn of the twentieth century the *majority* of the people in Western Europe and North America continued to live in the old way.

Most of them were still farmers residing in rural communities, following a rhythm of life that was not too distant from what had been known and practiced for centuries. With the notable exception of the few new capitalists and of the emerging urban middle classes, most people still lived in simple –totally inadequate by today’s standards– dwellings with no electricity, no running water, no adequate heating and no sewage systems. For many, the quality of life was poor and often appalling. Infant mortality was high, while many died prematurely because of influenza, tuberculosis, pneumonia, typhoid and other diseases –in the same way as it had been for centuries. People had some awareness that technology was changing the world around them. But most of them, aside from benefiting marginally, if at all, from these changes, were absolutely ignorant as to the dynamics of the process, let alone have a way to participate in it as protagonists.

If this was the picture in the so-called modern and advanced world until not too long ago, it is no wonder that “development” and “economic growth” both as concepts and as realities, (notwithstanding further and broader economic progress), took many more decades to reach beyond the traditional western world.

No wander that, even today, while westerners are engaged in debates about a “Third Industrial Revolution” caused by “the information revolution ” that has created a “knowledge-based economy”, both the ideas and the processes needed to engineer “growth” —any kind of growth— have yet to reach and touch the day to day lives of hundreds of millions of people on this planet, from rural India to rural Africa. And this is indeed the issue that we are confronted with: how to best try and make development the norm where it is not. Untold failures attest to the difficulty of this endeavor.

When the West was undergoing its industrial revolution, only very few in the rest of the world could have a pale idea of this unfolding process, its dynamics and especially its long term implications. Today, the situation is, of course, vastly different. Significant outposts of development have been created, exist and thrive well beyond the west an d westernized countries. Information about the technological and the tested policy tools that seem to foster progress is more readily available. And, nowadays, thanks to the internet, news can travel fast, even to the most backward corners of the earth. Likewise, both the amount and the speed of information transmission increase literally on a daily basis. By the same token, today, ideas about development and strategies to promote growth are the objects of intense debate across the board, including of course in Third World countries —sometime serious discussion, sometime mere lip service.

Yet, all this notwithstanding, the reality is that for hundreds of millions, to date, these are still scarcely, if at all, understood notions with little or no bearing or impact on their daily lives.

Economic Development: A New Reality without clear Causes

One of the reasons for this difficulty in making inroads in the minds of untold millions, is that even we, in the western, modern, technologically booming world, are still uncertain as to the “laws” (if any) that rule the growth process. We (usually) know development when we see it, but we are not exactly sure as to what it takes to have it. Indeed, right here, in the industrialized, developed world, where, at this stage, compounded, massive and very tangible changes have reached almost all strata of the advanced societies, we are still far from any intellectual consensus of what “development” is and –more importantly– what it takes to make it happen. We have problems with both the definitions of the concepts and their implementation. Economic development is a reality but its dynamics are still to a large extent an elusive mystery. Indeed, even within highly developed societies, some parts, regions or areas within cities do not participate; while others suffer from decline, development in reverse. Thus, many attempts at mastering it notwithstanding, it is clear that the development phenomenon is more art than science and it cannot be easily conceptualized within a body of clearly transmissible knowledge.

Yet, paradoxically, even without a full understanding of the process, the *reality of progress* has given life to a set of beliefs that –at least for some– amount to some kind of creed. By and large, in the west, most people today are born or have grown into adulthood with the axiomatic belief that they live in societies characterized by the reality of an ongoing “economic progress”, where “economic progress” is described as an achievable personal and societal goal.

Further, (regardless of the theoretical uncertainties mentioned above), for many westerners (if not most), overtime other assumptions and postulates managed to take strong roots. As a result, there is now a widespread belief that “*there are*” known, practical and viable economic policies and activities that would or should lead to the improvement of one’s material conditions, as well as policies that should favor broader economic dynamism and thus growth for the whole society.

Again, any cursory observation of ongoing economic debates shows that there are many unresolved and heated disputes as to how best to achieve these goals. The most disparate policies are heralded as absolutely essential by some, while the same are condemned by others as harmful to growth, if not utterly insane. However, despite conflicting views and confusion, at a deeper level, there is a faith that somehow, the broader goal of continuous progress is both attainable and necessary.

In fact, at this stage, the conventional wisdom in the West is that continuous economic improvement is deemed to be not only possible but indispensable. A century or so after sheer survival ceased to be the dominant preoccupation in the West, the constant improvement of our standards of living via wealth generating economic activities has come to be viewed as a necessity. In the West, the reality of growth has allowed the establishment of a belief, now entrenched, that tomorrow has to be better than today. If this does not happen *all the time,* then there must be serious ailments affecting the society in question. In fact, in the world that we have created, we have now the almost undisputed axiom that it is not possible to live a decent life without the constant improvement of material conditions –the benign outcome of economic progress. Majorities would agree that increased human satisfaction is related to increased wealth and improved living conditions. For these reasons, the promise of more, or more rapid, economic progress is a pledge routinely made on the part of the political elites of any given country seeking popular support.

For example, in the nineteenth century, the Brazilian ruling elites, strongly affected by positivism, inscribed the word “Progress” (after the word “Order”) on the country’s national flag. Governments the world over, almost by definition, are supposed to promote economic growth; while they are evaluated mostly in terms of their ability to improve the economic picture. Although we do debate as to the best mix of activities on the part of both the private sector and public powers that will improve economic conditions, we do generally share the belief that government has a major responsibility in fostering economic growth. In the United States, for instance, the most common, although largely flawed, parameter to judge a president's performance is "how the economy is doing" under his stewardship –even though it is well known that any president has very limited powers to influence economic performance.

Based on all this, we can say that, in Western societies, most individuals from an early age are taught that a) it is both desirable and possible for people to "advance economically" in the material world; b) that there are time proven ways, (such as hard work, starting a business, saving, improving one's skills through education, and so forth) to achieve this goal. Furthermore, these ideas are so deeply ingrained that we are now consciously or unconsciously "conditioned" to think in terms of *degrees of growth*. While many individuals may stay throughout their lives on an even course, or actually see the deterioration of their material conditions, if society at large does not "grow" economically, then people start worrying and begin to look for causes of "stagnation". If and when there is a net, albeit small, deterioration of economic conditions, then we must be in serious trouble. When we have severe economic stagnation or crisis, with accompanying unemployment and falling standards of living, concern may turn into real fear. In extreme cases this may cause social unrest or even revolution.

Development: For Most Still a Distant Concept

But there again, the West and the large portions of Asia and other continents that have adopted western approaches are not yet the universal standard. A large, if not the largest, portion of the world's population is still moving according to the old parameters focused perhaps no longer on sheer survival but still on subsistence. Most of the common people on this planet can scarcely begin to comprehend the concept of “man made growth”, let alone become actively involved in activities that would engineer such growth. For hundreds of millions of people on earth today, life is still about securing enough to get by today, in a world where they perceive opportunities to be determined by a “visible” pool of finite resources. This narrow worldview cannot conceive the notion of getting “more” out of what exists.

By the same token, those who live in realities dominated by the entrenched perception that resources are finite, by default, if nothing else, operate following a “zero sum game” mentality. According to this view, in any given situation, one can have more only by taking away something from others. Following this basic approach, the clever people become involved in activities (political, military or otherwise) that place them in the position to either directly control the existing pool of wealth or to acquire material gain by supervising its distribution. The name of the game is not “wealth creation” but instead “wealth control”.

Anywhere we have the predominance of thinking and practices aimed at wealth control, it is very hard –if not outright impossible– to have the germination, let alone the rooting of the idea that people can advance both economically and socially, not by taking away from someone else, in a zero sum game, but by creating something more and something new. In these circumstances, the mental path to even begin to think about increased “wealth production” is yet to be discovered.

No Theoretical Consensus in Developed Countries

But, as mentioned above, even in the modern, industrialized world, where economists have been theorizing for centuries as to the purported parameters that will cause or foster wealth creation, we have not yet mastered, agreed upon, or defined a proven method. We have produced large libraries of books on economic theory, models and analysis. But the most striking observation in reviewing economic literature is a lack of conceptual unity based on real facts. To date, economics is not a real “science”. At best it is a diverse, sometimes confusing, ensemble of widely differing theories. As yet, we have not been able to clearly identify basic principles which determine certain dynamics nor the ingredients that will trigger growth both in societies that have it and in those which do not have it or not enough of it.

It is important to stress that, thus far, we have not yet singled out the rules (assuming that they exist) nor devised a system that can generate and guarantee continuous steady growth. All this may appear quite paradoxical. The West embraced the concept of the possibility and desirability of growth long ago. One way or the other, growth, albeit uneven and often staggering, has become a tangible reality. Yet people after a century long debate have yet to agree as to what the recipe should be.

To cite just the most obvious example of a radically different approach to the goal of growth, Socialism (in its different varieties), was conceived and then applied –no doubt in good faith at least in some instances– as a supposedly better, indeed more “scientific”, way to secure the same goals of progress and growth –only to agree later on, friends and foes alike, faced with the evidence of monumental failure, that its shortcomings were far greater than its benefits.

But even in the Western mainstream we vehemently disagree about the right mix of ingredients for growth. We do not have clear recipes. Carefully crafted economic plans fail miserably or, at least, fall short of desired results. Conversely, periods of high growth occur without any clear correlation to existing economic policies. In some instances we have had economic reversals, painful and long (the Great Depression), in other instances some societies, try as they may, seem to be impotent prisoners of listless, anemic trends that fail to deliver on the general expectation that they should be moving forward. By the same token, even in societies that seem to be doing very well, such as the United States in the last decade, we are confronted with the phenomenon of significant portions of the population that neither participate in nor benefit from this unprecedented stretch of great economic dynamism.

Development: What are the Ingredients?

Whatever the outcome of their efforts, economists of all stripes for centuries have been trying to identify the key components of a growth-oriented environment. Of course, in the early days it was said that land was the key. Not exactly in this sequential order, they then discussed capital formation, the prerequisite for investments and thus future growth. Then they added inventions and technological innovations that could be industrially applied and commercially exploited. Then they considered raw materials; then population and thus market size, then access to markets and trade. Then they added the role of the State in aiding or impeding growth. Thus, a new focus on the need for appropriate macro-economic and monetary policies, a balanced system of taxation and the need to have good infrastructures that would facilitate economic activities. Then they discovered the value of skills and thus the importance of improved education standards, both in technology and management. Then they became conscious of the need for affordable sources of energy. Clearly all these are components of the economic process. They all matter as factors capable of influencing growth. But they matter in unequal and sometimes mystifying ways.

Countries with enormous reserves of raw materials and or energy are poor. Countries that have not been graced with anything at all by nature have become rich. Countries with benign weather are poor. Countries where people battle daily with the elements are rich. Some regions within countries do well, whereas others, although theoretically sharing the same macroeconomic and institutional environment, are doing very poorly. Even more interestingly, countries that used to enjoy economic leadership positions in the past no longer do today, while some new comers have managed to reach unimaginable heights in relatively short periods of time.

New Focus on Culture and Beliefs

Be that as it may, while the debate is still going on, there is now a growing consensus that the material components of the economic process (land, raw materials, energy sources) are comparatively less critical than we used to think. Whereas, more importance is attached to the characteristics of the society within which economic activities take place.

Thus more emphasis is placed on the existence or creation or strengthening of some basic institutional features. Among them: a government that can provide useful services at a moderate cost in terms of tax burden; a dependable legal system, (that would among other things guarantee private property rights and the enforcement of contracts); a good education system that will produce a competitively skilled work force, and so forth.

This new thinking has been reinforced by reflections on the failure of the socialist and other statist systems. Socialism did not fail because of lack of materials means. The former Soviet Union had practically all the basic ingredients for sustained growth: abundant agricultural land, raw materials, energy sources, a relatively good education system that produced capable scientists and engineers. And yet, the system eventually collapsed, literally on itself. Notwithstanding early successes based on the ability to coerce people to produce according to state plans, eventually the political, judicial and societal make up proved to be inimical not just to economic growth but to productive activities in general.

After the end of communism many, in a rather naïve fashion, thought that, with the elimination of this system so deeply hostile to growth, a functioning free market, capitalist system would more or less spontaneously blossom. According to this optimistic view, this would happen because the people would have the opportunity to follow the tried western blueprint but also because they would be driven by some kind of innate inner force that, barring no artificial obstacles, leads societies to free market capitalism and democratic institutions.

The conventional wisdom was that there is a “natural” human propensity toward free market capitalism, itself the fundamental engine of growth. Communism represented an aberration, a distortion forcefully imposed. Eliminate the distortion and the natural order of things would progressively assert itself. But the chaotic situation characterizing most post communist societies shows that this is clearly not so. Thus, the aftermath of the Soviet Union’s collapse reinforces the theory that the “correct” institutional-legal framework does not form itself naturally nor can it be just quickly superimposed on any given country through the work of well meaning advisors. *For such a framework to gain firm roots, it has to be both understood and believed. It has to become part of the shared worldview, of the psychological make up of the people*. (More on this later).

This assertion is further reinforced by observing a number of societies, especially in the Third World, that were not affected by the distortions of socialism. Decades after their leadership had claimed to have accepted and to be following the basic Western philosophy and practices which, according to the conventional wisdom, should induce growth, they are still not capable of making it happen. Now, why is it so? In order to at least try and answer these questions, we should revisit some of the ideas that have become something akin to axioms and dogmas regarding development.

Questioning the Conventional Wisdom

Although the debates as to which are the key ingredients of growth and the agents of growth have not been settled, at least at some level there is an almost unchallenged orthodoxy which has come to dominate "official" thinking, at least in the West, on these complex subjects. And this is the "classical" economic theory, which, notwithstanding the many instances in which it has been proven wrong by empirical facts, continues to have a surprising resiliency.

The Western classical economic thought that, to this date, continues to provide the elements and the framework for a large part of economic discourse, is rooted in the European rationalism of the XVII and XVIII Century. According to this thinking, Man is fundamentally a rational creature. Therefore, it is postulated that he will have a natural propensity to look rationally at economic activities. This will spontaneously lead him to constantly maximizing the use of resources in the most rational way to obtain the best return for the effort. According to this long established school of thought, there is a natural propensity to have an ever more rational and thus more efficient and productive allocation of resources itself based on a rational, intelligent use of available information, while intellectual efforts aimed at improving existing processes will lead to new inventions. It is important to stress that this classical economic thought postulated the existence of an innate human predisposition to look for better ways, to experiment with new technologies and to constantly refine processes in order to obtain the best return on any investment of resources.

In more recent times, new psychological theories made it apparent that capabilities and skills, including those "rational qualities" attributed by the classical theory to humankind in general are acquired through a process of learning, as opposed to being natural tendencies. The study of capitalistic economies has led many to observe that a higher degree of growth is a function of applied innovation in both products and processes which in turn leads to higher efficiencies, a higher level of productivity (higher output per unit of work) and thus higher wages and standards of living. The ability to innovate and to quickly find optimal commercial applications for innovation is understood to be a function of acquired and progressively refined skills for the individuals actually involved in the different stages of any productive process. The level of those skills is the key variable that can be modified, depending on the length and quality of the instruction provided to the individuals as well as their ability to creatively build upon it to engineer more and more innovation.

We thus define the individual's capability to perform in any economic activity as *the outcome of a learning process that includes material knowledge and an approach that postulates that progress can be constant and that it is within the mental abilities of all people to actively contribute to it*. In other words, people learn "things" but more importantly they learn a new approach about the possibility to apply ingenuity in order to constantly improve on what exists.

Thus, little by little, we are coming to accept the notion that at least certain critical components of the economic equation have to do *with conditions internal to the individuals*. These conditions largely determine what actions various individuals perform to create and alter external circumstances and the degree of *effectiveness* with which such actions are carried out.

Further, we have come to recognize that the actions of individuals are a function of their knowledge and skills combined with a new approach about creative thinking and that such skills are imparted through some kind of learning and or education process, formal or informal as it may be.

This is already a major shift. Little by little we are coming to believe that the individual and his/her range and level of skills is probably the single most critical variable in the economic process. Depending on what he is taught, or what he learns through experience, the individual is likely to do or not do certain things that are going to have significantly different economic consequences.

This is important. Modern thinking has moved away from the notion of a “natural, inborn propensity” to maximize value shared by all humans. But, although this shift is relevant, we have not yet grasped the full dimension of the issue. The current debate about skills is generally focused on applied knowledge. That is: how much economically applicable knowledge about science, technology, management and business practices has the individual received? From this vantage point, the individual is regarded almost as an empty vessel. Pour in the right mix of information, knowledge and training and he/she will perform in a way that will produce improved economic results.

It is undeniably true that certain specific and increasingly sophisticated skills are required to improve performance, as many economic activities are more and more tied to the ability to understand, manage and manipulate complex information. Yet, this approach, although largely true, fails to capture the broader picture.

The fact is that all these theorization about economic skills somehow assumes that economically relevant behavior is an independent variable, not tied to the rest of the person, his attitudes, beliefs, needs, aspirations and problems.

In a word, we seem to forget that the economic behavior of individuals can only be but a component of their global psychological formation and ensuing disposition towards all areas of their lives, including economically relevant activities. Whereas, it is the basic psychological make up that is the dominant variable. This make up tends to affect

all aspects of the individual's life – including his economic behavior.

Max Weber: The Unintended Economic Consequences of Religion based Ethics

A rather famous example may serve to illustrate this point of view. Long ago, the argument was made by the German sociologist and economist Max Weber that the successful emergence of capitalism was due or at least aided by a state of mind which was itself the byproduct of religious beliefs. In his seminal work "The Protestant Ethic and the Spirit of Capitalism", Weber argued that the early successful capitalists, especially in Germany and North America, were not originally driven by the desire to improve their material conditions *per se*. Rather, they were motivated by religious beliefs that influenced their economic activities and, as an *unintended* byproduct, made them successful wealth creators.

According to Weber, there is a correlation between the Calvinist theological belief of predestination and the development of a certain type of ethical and behavioral code that *just happened to be conducive to the development of successful capitalist systems*. Very briefly, belief in "predestination" meant that some individual souls were going to be saved and others damned according to decisions made by God. The individual was completely powerless in changing his predetermined fate. This could have plunged people into a sense of complete fatalism. Instead, the Calvinists, secure in this belief and also that, somehow, as witnesses of the True Faith they had to enjoy some special place, overtime developed a theory whereby there should be "signs" of predestination that would indicate to the "chosen ones" that they would enjoy eternal life. According to this view, success in the material world should be considered as a positive "sign". By permitting to an individual to improve his circumstances through his actions, the Lord would provide a sign of predestination. Whereas, the lazy, the drunk, the good for nothing, the failed were clearly sinner who could not possibly be among the saved.

In the austere Calvinist environment, the goal was not to amass wealth in order to live the dissolute life of the rich as in other societies. This wealth was a testimony of God's blessing. The producer was supposed to be the "steward", the guardian of wealth and not the consumer. The good Christian would live a sober, simple, laborious and honest life. Capital was to be created but not spent*; thus it would be reinvested*. Furthermore, the Calvinist, constantly under the watchful eye of the Almighty, had to behave according to the Biblical moral code. Honesty and integrity had to be part of his life just as hard work and frugality.

So, here we have the basic ingredients of capitalism: enterprise, a mind constantly focused on devising ways to rationalize processes and improve things, hence a bent toward seeking technological innovation, capital accumulation and reinvestment. Finally, we had a behavior that had to be respectful of the basic Christian rules –which happen to coincide, at least to a degree, with the rules of a free market economy. These rules would oblige individuals to keep their word, (i.e. contracts), to have respect for someone else's property and rights; while they would create at least some deterrent to those tempted to engage in theft or dishonesty.

In all this, the salient element is that a certain economic behavior that happened to be conducive to the strengthening of a capitalist market economy, *at least at its inception, found its roots and its legitimacy in transcendental concerns that had nothing to do with economic development goals.* According to Weber, a set of beliefs spurred people to act in a fashion that just happened to have significant economic consequences.

Now, we could debate to what extent Weber was correct in establishing a specific correlation and perhaps a causal link between a religious belief and the emergence of a particular economic system. Indeed, many have argued against Weber's theory.

A Step Ahead: Economic Behavior is a Component of the Person's Formation

But today, after the explosion of psychological studies encompassing practically every aspect of human life, few would seriously doubt that the ethical make up of an individual (which includes any values drawn from religion or ideology) and his general psychological conditions and disposition has no impact on his attitude towards all behavior, including economic activities. Most would agree that the inner core of a person's psyche, coupled with the type of education received and the culture absorbed, determine, among other things, an individual's level of dependability, conscientiousness, diligence, honesty, openness to change, willingness to take risks, etc. All these happen to be qualities that have a direct impact on that person's economic behavior as an employee, as an employer, as an entrepreneur as a civil servant or as a judge.

The relevance of this approach is recognized at least by some. Indeed, a very fashionable field of study in the Western world concentrates on "motivation": i.e. how to make someone focused and goal oriented in such a way as to improve their performance and effectiveness especially in economic activities. What is it that makes a worker eager to do better or that renders his performance lackluster?

Motivation gurus would disagree as to the best recipes; but generally they would concur that the key to change behavior and thus outcomes *is a positive modification of the individual's state of mind. And so, a constructive modification of the state of mind of those who are still outside the development sphere should be a logical component of any development strategy. And education about new ways of thinking and approaching reality is a lot more than skills* *training.*

“The Decline of America” Revisited

WASHINGTON – Remember Yale historian Paul Kennedy and his 1987 tome on “The Rise and Fall of the Great Powers”? At that time there was a lot of interest in this fairly comprehensive narrative focusing on how all major western powers, primarily because of the huge cost of maintaining their Empires, suffered progressive economic decline and eventual decay. Thus Spain –in Kennedy’s argument– thus Great Britain and thus –inevitably– the US. The book sparked a spirited debate about the future of the US as the leading power of the century. The combination of a sputtering economy, strong Japanese competition and raising security expenditures necessary to maintain the American Empire would lead to bankruptcy and thus to the inevitable –if sad–retreat from global ambitions. Kennedy’s work contributed to a new self-reflective atmosphere that gave rise, among other things, to efforts aimed at investigating the soundness of the main pillars that sustain the edifice of America’s might. Think tanks, the Congress, and the Federal Government launched studies, initiatives and task forces on “US Competitiveness” –or lack thereof. The newly formed bipartisan Concord Coalition started warning Americans as to the structural damage caused by runaway deficits due in large part to the unstoppable growth of spending on entitlement programs.

So, according to the conventional wisdom of the late 1980s, we were overstretched militarily because of the Cold War security commitments highlighted by the 300,000 troops permanently stationed in Europe, as our most visible contribution to NATO and by the questionable idea of spending billions of dollars on the Star Wars program, that is space based ballistic missile defenses. We had lost our edge in economic innovation. We were assaulted by the Japanese bulldozer from the East. This was the time, we should remember, in which the trade deficit was about Japan; while Japanese concerns had started a buying spree in America that, according to many, even serious, observers, had all the markings of a progressive take over of our economy. Meanwhile the “Europe 1992” agenda, the solemn commitment on the part of the then European Community to pull down residual internal barriers and create a brand new, vibrant market, seemed to foretell a new era of economic primacy for the Old Continent, engineered behind the walls of a “Fortress Europe” that –it was feared– would exclude Americans. Here at home, because of misguided fiscal policies and unhealthy personal spending habits, we –the Government and the individual citizens– were slowly but surely drowning in debt. That was the picture then. It was the widely shared notion that the economy was on the verge of collapse, especially after the mild recession of 1991 that propelled technocratic Bill Clinton and his panoply of new, original economic ideas (never really implemented, by the way) to the White House.

But, in the meantime, the unexpected happened –on many fronts. 1989 did not give us just the promise of German reunification. It was the first shock wave that signaled the collapse of the Soviet Empire and thus the end of the major threat to US security. The final demise of the biggest existential threat was the justification to significantly cut defense spending and international commitments in the 1990s. This dramatic change, combined with a resurgent faith in small government, especially after the republican revolution of 1994 masterminded by Newt Ginrich, meant that runaway federal spending could be contained.

At the same time, without the support of any particular blueprint devised in Washington, the information revolution was unfolding. Rather than creating a new economy, the massive adoption of IT by all businesses meant a massive leap forward in the competitiveness of the US economy. We had spectacular growth year after year, record low unemployment and high tax receipts that gave us for the first time in decades a federal budget surplus. At the same time, without the US lifting a finger, Japan, because of its internal social, rather than economic, contradictions, fizzled, while the predictions of the rise of a robust, innovative and economically powerful Europe proved to be quite wrong. And so, we had the roaring ‘90s: a prolonged period of American unchallenged economic primacy. The US was first in everything: innovation in high tech, creation of new employment, record productivity increases.

But it all seemed to have ended somewhat ignominiously with the beginning of the new millennium. We have had the dot.com bust, accompanied by the Enron, WorldCom, Adelphia and other well known corporate scandals which ushered the Wall Street contraction and the ensuing long bear market. The 9/11 attacks, occurring during this downward spiral certainly did not help.

And now, where are we now? There are disturbing signs that would indicate that Paul Kennedy and other were after all right in predicting decline. Only they were incorrect as to how close it was and what would cause it. The root cause is not “Imperial Overstretch”, but the erosion of US competitiveness due to lack of investments in both human capital and needed infrastructure, accompanied by the unstoppable growth of entitlement programs. Sure enough, at this time we also have a war. The prolonged Iraqi campaign has become stupendously expensive. But, regardless as to one’s own political opinion about the war, this commitment, in an as of itself, is economically affordable.

While a war and an increased Pentagon budget are a drain on public finances at the expense of productive investments, the real problems are in the same factors that were identified 20 years ago, at the time of the "competitiveness debate", by most sensible analysts: a more and more expensive welfare state that cannot sustain itself financially, and the progressive erosion of the education advantage that made America the principal player in the knowledge economy. If we continue to follow the notion that large segments of the American society, mostly the elderly and the retirees, have an inherent right to subsidized benefits that represent an excessive drainage of national resources, the federal government, even assuming the ability to finance these obligations, will have nothing left for productive investments. The secondary public education system, in turn, provides mediocre graduates, while minorities, on balance, do a lot worse than the already low average. It is impossible to sustain this increasingly complex economy without a dramatic improvement in the quality of the labor force.

The fantastic explosion of the trade deficit is the manifestation of eroded competitiveness. The 40 billion dollar deficits that scared us about Japan in the 1980s are pocket change compared to the 220 plus billion that we have nowadays with China alone, (not to mention the increased cost of our energy habits: at 300 billion in 2006, higher than the cost of imports from China).

Unfortunately, the argument on how to best rebalance our trade accounts has been successfully framed by a strange medley of simplistic romantics and demagogues who point the finger at the combined perils of free trade and outsourcing. By opening ourselves to foreign producers –so the refrain goes– we allow cheaper goods to come in. This means that US companies that have much higher costs go out of business or move overseas. Good American jobs go abroad because greedy corporations want to save money by having cheaper foreigners perform jobs previously held by higher paid Americans. The solutions advocated? Essentially close our borders, so that the jobs stay in and the foreign goods out. In this new era of global and irreversible interdependencies, the notion that this way we shall be able to regain, maintain and for ever keep our supposedly God given infinite prosperity is bizarre; but, nonetheless, it has strong emotional appeal.

However, if it is clearly futile to try and close our borders to keep cheap goods out or to prevent businesses from outsourcing, we still have a huge problem which is indeed caused by globalization. But not the globalization demonized by the protectionists. It is caused by the global spreading of the knowledge economy model developed first in America whose successful exploitation gave the US the edge for a number of years.

We have to come to terms with the fact that the genie of IT innovation has been out of the Silicon Valley bottle for a long, long time. We cannot restrict inventiveness and entrepreneurship –the key components of the American success story– to the American soil. The main ingredients of a knowledge based economy are transferable and so (despite copy cat failures and other clumsy attempts) they are transferred elsewhere today and more so in the intervening years.

True, the 1990s triumph of America's reacquired competitiveness was due to a complex mix of factors that cannot all be easily reproduced. The lively, free wheeling, chaotic mixture of entrepreneurs, academics, venture capitalists and their interactions with established corporate entities that buy, absorb, invest in new ventures, as yet, has no equivalent elsewhere around the world, in terms of depth and scope.But some of its elements can be replicated. No doubt, by trial and error in time others will manage to produce adequately funded innovative clusters that will be able to quickly direct new discoveries to a hungry global marketplace.

The celebrated Bangalore example in India is illustrative. Leaving aside all other considerations, the Indians have managed to create and aggregate in productive clusters world class human capital (scientists, engineers, software programmers) and to harness it effectively in competitive IT enterprises. To keep things in perspective, we should remind ourselves that Bangalore is still mostly about outsourcing and not about innovation. Moreover, the whole Indian high tech phenomenon is only a small speck within a still primitive Indian economy which is constrained by inefficient administration and crumbling infrastructures. India has an enormous population that is still largely poor or very poor. So, the days of Indian supremacy are still in the distant future.

But Bangalore and other such examples around the world will multiply, as more and more people gain access to higher education, IT literacy and mundane computer and business skills that cannot be kept within the West and America. The very information revolution unleashed by the American genius becomes the vessel that greatly expedites the transfer of knowledge that will create new centers of excellence where none existed before. Furthermore, the Indian example proves that we do not need an economy that is overall highly developed to create islands of modernity that can compete on practically any level with counterparts in advanced economies. Indeed, centers of competitive high tech can be established even without the fertile ground of an already developed economy that has already successfully dealt with macroeconomic issues.

These new enterprises, especially those established in business friendly developing countries where the cost of professional for many years to come will continue to be much lower than America’s, are bound to gain world market share, inevitably at our expense. If even a small fraction (as a percentage of the total population) of Indians and Chinese become good scientists, their absolute numbers will be sufficient to tip the balance. Our only hope to stay competitive is in continuing to invest in new technologies and new ideas so that superior innovative products and services will continue to be created in America.

But here we have a serious problem. Americans are so used to primacy that they do not believe that the ingredients that make this primacy possible need to be nurtured, refined and upgraded, especially now that we are confronted with new, capable competitors that have the added edge of a lower cost structure. (For instance, it has taken 20 years to the slow moving, no pun intended, automobile industry to have just recently what appears to be a collective awakening, with the active participation of the unions representing its thousands of workers. But it seems that only the specter of demise convinced the main players that dramatic cost cutting–be it salaries or health care benefits– is imperative in order to have a chance to compete. But, even if successfully implemented, these strategies are clearly not enough to get Detroit out of the woods. In the next few years we shall see whether the bitter cost cutting medicine will be accompanied by a new wave of creativity that is the real hope for recreating a competitive edge for this ailing sector).

While discussions about the international economy abound, for the time being, we have not framed the debate in a way that will foster real progress. Unfortunately, to the extent that the general public has been brought into the conversation, it is fed gross distortions and oversimplifications pointing at the consequences of lost competitiveness, such as job losses. The conversation is mostly on allegedly bad trade policies and greedy corporations. If we could only change Washington's direction on trade, all will be well. Indeed, the debate is mostly about identifying culprits and quick fixes. So, according to these critics, beyond the international trade policy incompetence (close to treasonous behavior), the enemies are the Asians, (yesterday Japan, today China) who do not play by the rules and the illegal immigrants who steal domestic jobs while depressing wages. This sort of populism may work with many constituencies in uncertain economic times; but it explains nothing about the causes of our ailments and its remedies would cure nothing.

The reality is that we have structural, systemic problems that need to be addressed now, so that we can begin to change course and hopefully improve our conditions for the long term. While the misbehavior of others is real (think of Chinese disregard for intellectual property rights and the ensuing flood of pirated software and counterfeit goods; think of the Mexican government actively encouraging the emigration to America of the country's surplus labor), there are inherently domestic structural deficiences that slow down America and that have eroded its ability to compete. To name a few critical ones: a deteriorating education system, the unsustainable cost of the welfare state and the lack of a serious energy strategy.

Clearly the soft underbelly of America is a mediocre to bad education system right at the time when new, world class centers of higher learning are sprouting around the world. America for a long time nurtured domestic talent while, by design or by default, (think about the intellectual migration to America from Nazi occupied Europe), it was able to attract first class minds from around the world. After all, Albert Einstein, Enrico Fermi and Edward Teller were not Americans. But they were welcomed in America and the American intellectual and scientific environment was able to absorb this talent and greatly benefit from it. In more recent years there has been a significant influx of gifted Asians. But now the pull of America is not as compelling as it used to be in the light of the fact that good opportunities exist elsewhere.

At the same time, it is now apparent that the American public education system, the incubator that should nurture the future scientists, engineers and entrepreneurs is at best mediocre, deeply flawed in its worst components and certainly inadequate to create the world class work force that will have to compete on quality, as costs already work against us. The existence of several world class universities is not sufficient to guarantee that the broader US workforce will be able to compete with increasingly more sophisticated foreigners. A sub par worke force will make it difficult to compete, let alone strengthen, our positions in high value added strategic areas.

While it is hard to admit it, a huge chunk of the old manufacturing base of America is either gone or going. We lost a lot of steel, machine tools; we lost footwear, apparel; we have disturbing signs that we cannot keep up in automobiles. We have a battle unfolding in aerospace. Still, American success stories in valuable, technologically complex industries (think of GE, 3M, United Technologies, Boeing among many others) show that, despite higher labor cost, superior quality, when it can be reinforced by constant refinement, still counts.

By the same token, we still have an edge in services. But this is entirely dependent on the continuous waves of IT innovation. If we are no longer on the forefront of IT, because we can no longer compete with increasingly more competent but much cheaper Indians and Chinese, we have lost the competitiveness contest.

Much has been said about the increased welfare costs due to the demographic changes that America is experiencing, along with most other developed countries. The question is whether it is smart, in the long run, to have a central government whose main function is to distribute benefits at the cost of everything else. Even now, while immediate solvency is not an issue, the federal government devotes relatively smaller portions of its resources to productive investments, given the weight of the entitlement obligations. As we all know, in the future this is only going to get worse. It is understood that taking something away from people who believe that they have earned a partially subsidized old age is extremely hard. But there is an opportunity cost in spending most of our revenues on welfare and little on competitiveness enhancing investments. Unfortunately few people enumerate the thousand of research projects or new infrastructure that could be financed by the federal government, assuming a reduction in entitlement programs.

The energy picture is dismal. We have excessive consumption, little and declining production and increased dependence on imports that is financially burdensome, while it creates a serious strategic vulnerability. What we need is not just the tinkering provided by this or that pork laden energy bill; but a bold new *energy strategy* that would set realistic goals regarding alternatives to hydrocarbons, while actively discouraging consumption through revenue neutral gasoline taxes. In doing so, America would free itself from this straightjacket, while possibly becoming the world leader in all new technologies related to alternative energy.

But in all these areas: education, welfare reform and energy, while there is a debate and many have offered sensible solutions, we are far from having reached the deep understanding that is the prelude to decisive action. While many are worried, most believe that things are more or less fine and that we have enough slack to muddle through.

In hindsight, similar historic circumstances characterized by a passive attitude that in effects allows the sliding into decay (and here we go back to Paul Kennedy) are recognized as due to a state of mind of myopic denial and complacency of people who have lost their way. But usually this is the verdict of historians. And when they pronounce it, it is too late to change anything.

Development is not “Poverty Alleviation”, it is About Creating Wealth

by Paolo von Schirach

June 28, 2007

WASHINGTON – How an issue is defined goes a long way in shaping the nature of the efforts aimed at dealing with it. For example, the Bush administration’s framing of America’s serious challenge from religious fanaticism as “The War on Terror” has caused people to focus on “terror”, that is the *modality* with which certain hostile policies (acts of terrorism) are perpetrated, as opposed to concentrating the bulk of our energies *on the ideas and beliefs that motivate radicals up to the point of encouraging them to engage in terrorist attacks*. Our real problem stems not from people who do certain things; but from people who think in a certain way. Their actions (terrorism) are the modalities with which they express their psychological and intellectual make-up. If we focus mainly on the acts of terrorism, (how to counter them, how to minimize there incidence, impact, etc.), the war on terror becomes the equivalent of a war on mosquitoes. By definition, it focuses on identifying and eliminating each and every mosquito (terrorist), one by one. Whereas the root causes are in distorted thinking that needs to be somehow corrected. This may not be at all easy, as we do not really understand the thought processes of the radicalized individuals; but that’s where the issue lies. To try and eliminate terrorists one by one is an almost hopeless proposition, as their ranks are replenished rather quickly.

In a totally different context, the broad objective of the international development community vis-avis the third world has been defined as “poverty reduction”, or “the fight against poverty”. The World Bank, the most important multilateral lending institution focusing on development, is “Working for a World Free of Poverty”. Its Mission statement is “to fight poverty with passion…” So, poverty as a condition, rather than what causes poverty, is the focus of our attention here.

To some extent, this emphasis on “fighting poverty, or poverty alleviation” is public relations, the attempt to deflect the critiques of the anti-global movement that, years ago, elaborating its conspiratorial theory that would capture the root causes of the planet’s ailments, bunched together the World Trade Organization, the International Monetary Fund, the World Bank, and multinational corporations as demonic instruments working together to further mankind’s misery in general, and the exploitation of the third world in particular. Hence the desire on the part of the “development industry” to improve its image by presenting to the critics objectives that would humanize their institutions. “Hey, Mr. No Global, we are with you. We are fighting poverty. We just want to help the poor”.

Undoubtedly there are other factors that can help explain this “fight against poverty” focus. At least to some extent, this Good Samaritan attitude stems from religiously derived ethics that have shaped the dominant Christian cultures. Hence, over the centuries, the proliferation of a vast universe of charitable initiatives within Christendom aimed at the poor. The moral obligation to give to the poor is the other side of a parallel moral bias against excessive wealth present in Christianity. The remedy to this inequality is for the rich to give away some of the excess. But giving to the poor in general was not aimed at having a truly transformative impact. It was meant as a good deed that would alleviate the painful conditions deriving from a state of poverty that was, however, considered to be a given for some segments of society.

It is difficult to evaluate the deep motives of modern day wealthy philanthropists who contribute to relief initiatives, whether defined as poverty reduction or not. But it would appear that the likes of Bill Gates fall pretty much in the same category of those who attempted to redress and alleviate. The primary focus on child immunization pursued, no doubt very competently, by the Gates Foundation, noble as it is, taken by itself, is not transformative. (To the extent that Gates and other wealthy donors are now shifting to initiatives aimed at fostering the creation of opportunity in poor countries, for instance through upgrades in education structures, they seem to have appreciated that a new mind set and new skills can and should be the foundations for wealth creation activities. We shall see how profound a shift this may be).

The issue of poverty is unsettling for western Christian culture, to the extent that it has been explained away as a product of bad luck that can and should be somehow remedied through charity. Indeed, in polite company in the western world the poor are often described as "the less fortunate among us". Let's think about it. We (the well off) "have" because we have been fortunate, the others, alas, less so. Again, words have meaning. According to this definition, our economic station in life is about having been more or less fortunate, that is random distribution of luck. The poor happen to be poor because, look at that, they have been less fortunate than we have. At some level this is true, especially in the case of children. Some are born in rich circumstances and some are born poor. Clearly those who were born in privilege have and enviable head start. But this is only a slice of reality. Most millionaires in the US are self-made people, as opposed to lucky beneficiaries of inherited wealth. This means that an open system that will not create artificial obstacles allows people to forge a better life for themselves. This has preciously little to do with "being fortunate". The use of these misleading definitions distracts us from confronting the real issues. Poverty is mostly about the bad combination of lack of opportunity (broadly defined) and lack of entrepreneurial drive –the necessary precondition to create wealth creating activities. If we do not tackle these two issues by creating opportunity and by instilling the will and the ability to create enterprise, we shall continue to provide relief to the poor, without offering a realistic new path. To borrow from the old story about the qualitative difference between giving somebody a fish and teaching them how to fish, the fish hand outs continue, while the fishing schools are scarce.

Even the most superficial analysis shows that wealthy societies did not become wealthy because of random circumstances, because they won a major lottery. Leaving aside all the defects of capitalism, at a macro level the capitalistic economies have been successful because the institutions created by societies allowed or better yet fostered a reasonably good functioning of the engines of wealth creation mobilized by private initiatives. As a result of the activities created through these engines, poverty, at least extreme poverty, has been eliminated. Prosperity is the outcome of a mind set focused on wealth creation on the part of many inventors and risk taking capitalists. The outcome, consisting in a vastly improved standard of living, has nothing to do with "being fortunate".

Be that as it may, the development practitioners have identified poverty elimination or reduction as the mission of development. In so doing, wittingly or unwittingly, they focus (and make us focus) on the effect of lack of economic development (poverty) and what we can do about it, rather than on a credible way out of it that can only be centered on an economic development agenda. This predominant focus on the manifestations of underdevelopment, rather than on planting the seeds that may foster growth, encourages the misallocation and outright waste of limited resources, all in the name of the “fight against poverty”. From this standpoint, for instance, it is considered good to create activities that generate some new income for the poor. However, analysis of the reasonable chances for such activities to be self-sustaining is quite often left out, as the focus is in “doing something” to diminish poverty. As a consequence of this approach that focuses on creating improvements based on wrong or incomplete analysis, very substantial resources have been squandered, although in a well meaning way, in the effort to reduce poverty.

Needless to say there can be a legitimate chicken and egg debate about “poverty as lack of economic development”, versus “the condition of poverty that, as such, prevents building the foundation for economic development”. It is obvious that the sick and the hungry cannot possibly engage in any economic development. Still, if we focus most of our resources in improving what is a very bad, even horrible, environment, without recognizing the absolute necessity to help create and turn the economic wheels as soon as possible, at best we have accomplished relief. And this can have a real impact that will reduce poverty. But we will have not caused any meaningful qualitative transformation; as this can be defined only in furthering societies on a safe path towards self-sustaining economic growth.

Unfortunately, by defining one’s work in the reduction of the extent of a bad condition, we are limiting our thinking and our actions. “Development”, after all, as the etymology indicates, should be about “unwrapping” something, and thus it would suggest an upward movement towards a better situation. Thus, both in terms of proclaimed objectives as well as policy, the focus should be on the tools, the frameworks and the engines of wealth creation, as opposed to reducing something negative. Since the only way up and away from poverty known in history is economic growth, why don’t we say openly that economic growth is the means through which we can achieve sustainable development?

Contemporary examples simply reinforce this truism. Structural change implemented by governments in some key poor countries improved the “enabling environment” for wealth creating activities, with the consequence of allowing hundreds of millions to be more productive *and lift themselves out of poverty*. The different stories of China and India in the past twenty to thirty years have been told many times. The important element is that the activities of donors and aid programs have had very little impact in these gigantic, systemic changes. The key factors that unleashed these positive energies have been economic liberalization policies that encouraged people to be productive, to invest in new enterprises and make money without penalties or fears of being dispossessed. Poverty reduction has been the byproduct of almost unprecedented rates of economic growth; not of policies that identified it as the scourge to be eliminated.

But, somehow, the notion of economic growth as the primary focus of development does not appear to be a noble enough purpose. At least for some, it conveys the images of rapacious businessmen, corrupt practices, wheeling and dealing, profiteering, domestic and foreign exploitation perpetrated by the unchecked powerful and –worst of all– growing economic disparities within societies. All this, unfortunately, is part of the picture, at least to some degree. Economic development, while crucially important, rarely occurs in a linear, harmonious fashion, with gradual, fairly distributed benefits for all. It is a messy affair, especially in developing countries that lack the framework of laws and institutions that should at least limit excesses and protect people from injustices. Efforts to build reliable and fair frameworks, difficult as they may be, have to be part of any economic growth strategy. However, the existence of significant flaws in how economic development occurs does not disqualify the basic proposition of wealth creation as a precondition for any lasting improvement in the human condition. There is no other. Whereas there are many who, contemplating the negative aspects of uneven economic growth, affirm that, unless this process can be properly regulated to ensure fairness, then it is better not to have it all. So there you have it: poor but equally poor.

The inability to put economic growth front and center in the framing of development agendas in part can be explained by the cultural make-up of the practitioners. The development environment is populated mostly by public “donors”: states and multilateral institutions; along with large, religious or lay private charities. Programs are quite often administered by an ever growing number of not-for-profit entities. Most of the actors in this system are civil servants and functionaries. Being part of large, public bureaucratic institutions depending on public funds, as a rule they do not like, know or understand business and what it takes to make it happen and flourish. For many of them, fighting poverty is a noble endeavor for the good of mankind. Pushing people to make a profit in a competitive environment – the indispensable lever for economic growth– is about promoting self-centered and egotistical drives, therefore not at all laudable if not morally questionable.

However, lacking a clear focus on growth as the paramount strategic objective, the goal of achieveing development through poverty reduction is likely to be an endless task. True, with all these efforts, the poor may become less poor, but they will not know much about getting richer through competitive enterprise.

Asia has reduced poverty largely through the eliminations of barriers to economic activities. On the other side of the divide, we have the sad story of Africa as the paradigm of what has gone consistently wrong, despite decades of well meaning efforts aimed at reducing poverty and improving overall conditions. Whatever has been tried, it failed to create (with few exceptions, of course), an environment in which enterprises could flourish, with the attendant outcomes of wealth creation and consequent diminution of poverty. This massive failure, by itself, should provide enough material for reflection on the validity of the current approach. Still, as yet, this reappraisal has not taken place.

How "World Bank War I" Really Ended

by Paolo von Schirach

May 22, 2007

WASHINGTON – 'World Bank War I' is over. President Paul Wolfowitz has been routed. He is out. The Europeans and their allies won. The allegedly unpalatable, non collegial, president has been successfully removed. However, almost all would agree that his baffling bad judgment in the now infamous matter of the overgenerous financial arrangements related to his partner's secondment -serious as it may be– would have never developed into a crisis in a different political climate. Wolfowitz, representing most of what the Europeans (and others as well) strongly dislike about America's recent policies, unfortunately, with his own doing, created a valid pretext leading to his removal.

The score is clear: Paul Wolfowitz and President George Bush who sent him there lost. By conceding tactical defeat on Wolfowitz, (thus not forcing an embarrassing vote by the World Bank Board), the Bush White House regained some leverage and the right to put forward another American candidate of its choice.

This is more or less the gist of it.

But there is another level to this story that merits attention. And this is the discrepancy between official acts (the Word Bank Board statement that ended the crisis) and previously declared beliefs and intentions. A hiatus between what is formally declared and what everybody who knows anything knows that the declaration ‘really’ means. The Board v. Wolfowitz case is just one of many instances of a dissonance between the wording of public statements that supposedly should reflect for the record feelings, beliefs and judgments and the actual situations and beliefs. The cognoscenti are fully aware that what is formally stated is not what is meant. And this is perfectly fine. We are so used to this dissonance that it does not provoke any reaction. Those who are dismayed are the naive and the unsophisticated.

Because this particular case is fresh, it is worth commenting upon. And it is worth commenting upon because it should matter that in our civilized world in which the paramount importance of ‘values’ as the true pillars sustaining societies is so often trumpeted, it is perfectly alright, in fact an indication of superior wisdom and diplomatic mastery, to make statements for the record that would indicate a certain sincere judgment, while everybody knows that this is not what is meant. The realists and the sophisticated really know what is going on. They know the real story and they can read between the lines. As for all the others -well, who cares?

In the case of the World Bank, the realists would say, a crisis has been resolved, without open confrontation and ensuing further embarrassment and weakening of the institution. The intended result (getting rid of Wolfowitz) wanted by the majority has been achieved. ***The fact that this has been accomplished through an official Board statement that, in its substance, openly contradicts the validity of the***

initial accusation and findings, apparently, does not matter.

The sequence of events is well known. First the revelations about "the girl friend deal" and the ensuing fracas. Then the results of the formal inquiry that found Mr. Wolfowitz guilty on many accounts were presented to the Board. And then, what happened?.

Well, and then the Board official statement that Wolfowitz in his defense said he acted in good faith and "we accept this". In a normal world in which words mean what they are supposed to, the Board statement equals to a full and complete exoneration.

The Board's words mean: "We listened to the report and its conclusions that Wolfowitz acted wrongly on many accounts. But we accept as a fact that he acted in good faith. Furthermore, we (the Board) also accept that there is plenty of blame shared by others. Indeed, the procedures at the origin of this mess are so confusing that the Board thinks that a thorough review of such procedures is now in order."

Of course, the Board's statement does not say that the accusations of the committee are false. However, it says that the good faith of president Wolfowitz is established. It goes on to say that many good things happened during his two year tenure. So, by any reasonable standard, the president of the institution may have materially committed some errors; but his good intentions and his ***ethics*** (this is what the inquiry was about) have been affirmed.

And so, in the light of this assessment by the Board, the formally and officially exonerated president ***resigns***? Talk about *non sequitur*. Well, yes. He goes because this was the deal. He agreed to resign, in a backroom deal negotiated by his lawyers, in exchange for this very statement that would formally exonerate him.

So he can produce for now and for posterity a face saving document, while the Board can produce what (they would argue) really matters: a political result. He is out; and that is what we all wanted, no? The fact that the Board, in order to secure its political end, in complete and utter cynicism, was willing to state as fact what it clearly does not believe in and that, in principle, undercuts the rationale for removing the Bank's president, shows that principle means nothing whatsoever in this matter.

And all this, let us not forget, in a matter that was about ***ethics*****,** a matter in which supposedly the Board had to evaluate character and motives, more than just actions.

So, the fact of the matter is that all concerned, friends and enemies alike, know that Paul Wolfowitz, whatever his bad judgment and errors, has been successfully stabbed by a coalition of people who dislike whatever they imagine he represents (the Iraq War, bad management style, arrogance, and, probably central to all this, a real threat to the opaque *modus operandi* of a complex institution). He has been effectively tarred and feathered and run out of town.

However, both he and the Bush White House can exhibit the only official document that counts in which it is clearly said that his good faith is established, that unknown others contributed to this mess and that the Board praises his two year tenure. So there. Wolfowitz resigned. But the record established with unequivocal words that his *bona fides* has been recognized. He is a good man who can stand tall. Next question?

Prior to this conclusion, the media had leaked this very scenario: forced departure; but with the fig leaf of formal exoneration. And this is precisely what happened. It is fully understandable that, having lost any residual political support and thus the war, Mr. Wolfowitz wanted to extract at least this token 'victory'. So, he is being ousted for being a 'bad guy', the hypocrite who does not walk the talk when it comes to governance and favoritism; but he can say that "*No,* *this is not true; and I have the Board document that exonerates me".*

The fact that Mr. Wolfowitz wanted this document is understandable, also because he honestly believes this to be the truth. The fact that the Board of Directors of the World Bank, in an issue of ethics and thus transparency, agreed to this sadly demonstrates that they were not really concerned with establishing the truth or in recognizing and assigning blame in a matter of unprecedented gravity, as it had been claimed all along.

They wanted a political result and they got it. The fact that, in order to get what they wanted, they had to officially affirm, for the record, the opposite of what the allegations and the findings had concluded, is a glaring contradiction. Yet, on the whole, this appears to be a trivial detail. So trivial that it has not been noted by most commentators.

Only the radical opponents of Mr. Wolfowitz who most likely believe that he truly is the devil incarnate expressed dismay at the wording used to finally resolve the matter. Indeed the record does not say that he is fired because he is the devil, as it should, according to them. It does not even say that he is a despicable person. So, what was this all about? Where is the indignation of a Board determined to fire Wolfowitz?

Misguided as they may be, at least the "purists" believe in coherent behavior, and thus they cried foul. (However, the indignation of the Bank's staff, a significant factor in the Wolfowitz crisis, becomes irrelevant when it comes to criticism of the way in which the Board handled the matter).

By choosing to be "realistic" and by accepting this *quid pro quo* that formally exonerates Wolfowitz, the Board proved that this whole exercise was about politics and not about principle, as it had been declared by the vociferous army of the righteous which includes many of the Goverments represented within the Board.

Alright, many may conclude. It may very well be so. And so what? All this to make a case about the prevalence of cynicism in politics? ‘What a revelation”! Of course, this is not a great new finding. It is a banal statement of the obvious.

Indeed. But if we think that any principle based political process, at the World Bank, in the US Congress, or in any other democratic institution, western or non western, can thrive in the long run in an environment in which it is established, indeed postulated, that utter insincerity is the norm, we are really kidding ourselves.

Principle based institutions can survive only if there is the shared perception that the principles are truly believed and sincerely upheld, if not by all, at least by most, and not just mouthed. This may very well be banal; but continuing to ignore this truism will not do us any good.

Green is Business

WASHINGTON – “Green” is increasingly business – good business – around the globe. True, favorable regulatory and fiscal arrangements are still necessary to guarantee the viability of many businesses that produce and market environmentally friendly technologies. But subsidies are less crucial these days. Take wind mills for electric power generation in which Europe is the leader. The European Wind Energy Association indicates that since the 1980s the cost of producing wind power has gone down by 80 per cent. For more significant penetration around the world, the International Energy Agency calculates that costs will have to be cut by at least an additional 30 percent. Yet, European wind power industry leaders are confident that continued investment in R & D and economies of scale due to increased sales will accomplish this. Demand is growing. The sector is expanding.

BP Solar, the solar power generation unit of British Petroleum became profitable in 2004 with increased sales of 30 percent worldwide. So, the non oil offshoot of a major oil company is viable.

President Bush, speaking recently at the Virginia BioDiesel Refinery in Virginia, stated that, while biodiesel made with soy beans generated only 500,000 gallons of fuel in 1999 in the US, last year it accounted for 30 million gallons. Oak Ridge National Laboratory estimates that ethanol and biodiesel combined could provide up to one fifth of transportation fuel in the US within 25 years. Clearly a long way to go. Still, who would have thought 20 years ago of a US president stating that transforming soybeans into a cleaner transportation fuel is a real business?

Well, if we had any doubt left that the environment is now mainstream business, it vanished after Jeff Immelt, the CEO of General Electric, in the course of a carefully choreographed recent event in Washington, announced that the number two U.S. corporation in terms of market capitalization intends to focus on water and energy technologies as key components of its business strategy.

Under the banner of "ecomagination" GE will aggressively increase R & D funding and devote additional corporate resources to promote at least 17 proven technologies – from energy production to efficient engines to water filtration – that will improve the earth's environment and thus the quality of life for millions of people. The technologies' net effects will be measurable and the data gathered will be made public, thus creating standards that may help guide public policy. Among them: cleaner coal burning power plants whose costs will be brought down through increased efficiencies; more efficient engines for locomotives, airplanes and cars with lower emissions; desalination plants to increase water supply and filtration systems to make it safe. Immelt is sure that, by providing environmentally friendly solutions that address real needs, GE will make plenty of money. So, “ecoimagination” is not window dressing. This is core strategy.

Immelt’s reasoning is straightforward. The carbon based world economy is under severe stress. Oil at $ 50 a barrel is a reminder that we in the U.S. but also in the rest of the world depend on a source of energy that is increasingly more expensive, more scarce and potentially subject to supply disruptions; not to mention the pollution byproducts. Likewise, environmental concerns are no longer just niceties. They are at the center of the quality of life that we as human beings are going to enjoy.

If this is true in general, the argument for the adoption of state of the art new technologies is even stronger for poor countries. For the many and growing billions who live in the developing world there is a desperate need for new solutions. Indoor air pollution is a killer in rural areas and air pollution a menace in huge urban areas, while rampant disease due to unsafe water and non existing sanitation is only going to grow without the massive introduction of new technologies.

Tens of millions of Chinese (7 out of the 10 dirtiest large cities in the world in terms of air quality are in China) live daily with the consequences of extremely high air pollution in terms of diseases and lost productivity. And a study by the investment bank CLSA* indicates that China, already relying on coal for 68 percent of its primary energy consumption, will see air pollution increase 4 times 1990 levels by 2030. (Victor Mallet of The Financial Times writes that air pollution blowing from the heavily industrial Guangdong province has caused a severe deterioration in the quality of life and thus economic damage to environmentally conscious Hong Kong).

China is the world's fastest growing economy. Immelt's GE has already estimated that China and other large growing developing economies (India, Indonesia, Turkey) will provide in the years ahead 60 percent of the company's growth. In launching the "ecoimagination" strategy, Immelt now connects the dots. He is clearly planning to make China a big buyer of these technologies. And why not? China is committed to growth; but not at the cost of self-destruction due to environmental ruin. If GE can provide solutions that do not sacrifice growth, they'll buy them.

Of course, other major international players such as Siemens, ABB or Suez are already doing this in China and around the globe.

But GE's announced strategy has similarities to IBM's decision to enter the PC market. That move indicated to all around the world that PCs were a real business with long term prospects. As GE joins the environmental technology pack, by virtue of this powerful endorsement, the pack is bound to get bigger and bolder. The promise is that this new focus will fill real needs. In the developed world it will help cut energy costs, while improving the environment. In the developing world GE and its competitors can become key enablers for true, sustainable development.

Finally, if the environment proves to be big business, then it may provide the competitive edge that the US and the West in general need in order to maintain leadership positions in the world economy. In the 1980s, when we started hemorrhaging manufacturing in America, very few thought that Information and Communication Technologies could create high value products and services and significant new employment. Maybe environmental technologies and the myriad of services that are bound to sprout and develop around them will help unleash the next wave of American innovation.

*Air Pollution in Asia: www.clsau.com